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In the Supreme Court
OF THE
United States

October Term, 1942

No. 392

Stuart Daggett, Sr., and American Trust Company, Executors of the Last Will and Testament of Estelle P. Clark, Deceased,
Petitioners,

vs.

Commissioner of Internal Revenue,
Respondent.

PETITION FOR WRIT OF CERTIORARI
to the United States Circuit Court of Appeals
for the Ninth Circuit
and
BRIEF IN SUPPORT THEREOF.

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STUART DAGGETT, SR., and AMERICAN TRUST COMPANY, Executors of the Last Will and Testament of Estelle P. Clark, Deceased,
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Respondent.

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To the Honorable Harlan Fiske Stone, Chief Justice of the United States, and to the Associate Justices of the Supreme Court of the United States:

Come now the petitioners above named and respectfully pray that a writ of certiorari issue to review the

Throughout, the italics in this Petition and Brief are ours.

judgment entered May 28, 1942 against them by the United States Circuit Court of Appeals for the Ninth Circuit. (R. 133.) The judgment was rendered on a petition to review the order of the Board of Tax Appeals which determined that the Commissioner of Internal Revenue properly assessed against Estelle P. Clark a deficiency of $2365.00 of income taxes for the calendar year 1936 and of $1149.15 for the part of the calendar year ending September 19, 1937, the date of the death of Estelle P. Clark. (R. 26.)

The judgment affirmed the order. Petition for rehearing was denied July 15, 1942. (R. 134.)

The judgment was by a divided court.

Daggett v. Commissioner of Int. Rev., 128 F. (2d) 568;

R. 110 to 133.

The case was heard before the Board upon a stipulation of facts and accompanying exhibits.

Petitioners are the executors of the will of said decedent, having been appointed as such by the Superior Court of Alameda County, California. (Par. 9, Stip., R. 40.)

Each point relied on herein was carefully set out in the assignments of error contained in the petition for review filed in the Circuit Court of Appeals. (R. 33 to 36.)

SUMMARY STATEMENT OF THE CASE.

The case is an alimony trust case. It is our earnest contention that the recent case of *Pearce v. Commissioner*, ... U. S. ......, 62 U. S. Ct. 754, 86 L. ed. Adv. Sheets 679 ...... U. S. ......, and the cases there considered were determinative. By a divided opinion, the Court ruled otherwise. Possibly it should be said that the majority opinion has restricted the scope of the *Pearce* case and the cases which it reviews by holding that although the income of an alimony trust is, under the facts, income of the husband prior to his death because it secures his contract to pay sums to his wife for her support, the death of the husband prevents a like holding as to any sums which his contract has made payable at a time which may be after his death, although the identical security arrangement was made effective so long as the payments were to be made. The Court may of course at once have in mind that the weekly payments which were to be made to the wife in the *Fuller* case were to continue for ten years and that the husband might have died the day after the divorce and that the guaranty of income which it discussed in the *Leonard* case was to be effective so long as the wife lived, which might exceed the husband's life. It would seem that the minority opinion is right.

The *Pearce* case shows that if a husband and wife make a separation agreement under which the husband creates a trust and grants to the wife the right to receive the income thereof for her support, the in-

come of the trust will be income of the husband under the following conditions:

1. If the husband guarantees the trust income will be certain amounts, the income is treated as security and as income of the husband and this is so although divorce follows and under the law of the state where the divorce is granted the Court loses jurisdiction to alter the payments.

2. If the agreement provides that the right of the wife to support is limited to the trust income, it is still income of the husband, if divorce follows and the jurisdiction mentioned is not lost. If such jurisdiction is lost, the right to the trust income is treated as a lump sum settlement and the husband is released. But mere contingent liability requires holding him liable for the tax on the income (if, of course, his total net income makes him subject to a tax).

3. If the trust remains largely in the husband's control and he retains a substantial interest in the trust corpus or its income, the trust income remains legally that of the husband.

The burden of proof is on the husband. The wife establishes the trust income must be taxed to the husband unless the husband clearly establishes the fact of release by local law and that he is not bound by contract and that the trust is not a trust in which he retains an interest and over which he has control.

The taxing of the trust income was governed by sections 161 to 167, inclusive, of the Revenue Act of 1936 (49 Stat. at L., pages 1706, 1707), the sections

now being sections 161 to 167 of the Internal Revenue Code, adopted February 10, 1939 (53 Stat. at L. 32). Section 167 of the Revenue Act of 1936 is headed "Income for Benefit of Grantor." Section 167-(b), Regulations 94, which section is set out under Section 167 of the Act of 1936, reads:

> "* * * Such a distribution to the grantor occurs *if the income is paid to him or to another according to the grantor's* direction or, if, though paid to another pursuant to the terms of the trust, the benefit of the income inures to the grantor. The income so inures if it is or may be applied in satisfaction *of a legal obligation* of the grantor, does or may increase his net worth, does or may in any way enrich him, or does or may enable him in any way to enjoy, in substance, such income. Such a distribution also occurs if the income is applied in payment of premiums upon policies of insurance on the grantor's life." (Italics ours.)

Section 19.167-1(b) of Regulations 103, set out under section 167 of the Code, reads:

> "Thus, the inclusion of any trust within the scope of section 167 is based on the fact that the grantor has retained an interest in the income therefrom by which he is, or may be enabled at some time, to receive its benefits. But the provisions of section 167 are not to be regarded as excluding from taxation to the grantor the income of other trusts, not specified therein, in which the grantor is, for the purposes of the Internal Revenue Code, similarly regarded as remaining in substance the owner of the trust income. If, for example, trust income is applied in satisfaction of the grantor's legal obligation *whether to pay*

a debt, to support dependents, to pay alimony, to furnish maintenance and support, or otherwise, such income is in all cases taxable *to the grantor.*"

Section 162 of the Act of 1936 is identical with Section 162 of the code. Subdivision (b) of the section prescribes that where the income of a trust is regularly distributable to a beneficiary such income is not taxable to the trust as a person but the same is merely included in the gross income of the distributee. Thus a distinction is drawn between the taxing of such income and the taxing to the trustee of income that is the result of accumulations or the result of capital gains. Application by the trustor of such income to the payment of his debts equals the receipt of it by him. Regulations 94, Article 162-1(3) contain the following:

> "Any income of an estate or trust for its taxable year which during that year may be used, pursuant to the terms of the will or trust instrument, in the discharge or satisfaction, in whole or in part, of a legal obligation of any person is, to the extent so used, taxable to such person as though directly distributed to him as a beneficiary."

This identical language is found in Regulations 103, Sec. 19.162-1(3).

The regulations are clear that a wife who receives support payments does not receive income. The husband can not deduct the payments. We quote:

> "* * * and an allowance paid under a separation agreement are not deductable from gross income."
>
> Reg. 103, Sec. 1924-1; Sec. 1922 (b) (3)-1.

The said majority opinion shows, and in this case it will be conceded, that the separation agreement involved provided for payments by the husband to the wife for her support *for life;* that the husband set up a trust the income of which was to secure these payments, that the husband guaranteed the payments would be a specified amount annually; that divorce was granted and that the divorce Court lost jurisdiction over the subject of alimony; that the *agreement recited that the payments to be made to the wife were what should be adjudicated in her favor, for her support; that a judgment was obtained on the wife's behalf establishing that and establishing that the contract bound the former husband's estate; that this judgment determined the trustee was entitled to recover from the husband's estate an income deficiency of $4040.06 for the fiscal year of the trust, July 7, 1935 to July 7, 1936, and that this judgment became final.* This judgment embraced a period after the husband died, for he died on December 9, 1935. The government has not so much as suggested that this money was the wife's income. It will be conceded that in these respects the case originally came within the first class above. We urge that it was also within the third class, although we believe it will not be necessary to consider that point. But the Court by its majority opinion ruled that as the husband died on December 9, 1935, the trust income in question between that date and September 19, 1937, the date of the death of the wife, was income of the wife.

While the majority opinion states that the estate of the ex-husband would be liable only for *deficiency*

in trust income and seemingly suggests that for that reason the income was not security, the distinction is in view of the *Leonard* case, clearly groundless. Moreover if such was the law the wife would always be held for the tax in those jurisdictions such as California where security must be exhausted before seeking to hold the debtor. (217 Cal. 644, 20 Pac. (2d) 940.) Equitably such a distinction is groundless. If the creditor must otherwise satisfy the debt, he uses up an equal amount of property. If the point were good, it should have been applied in the 23 years that preceded the husband's death. The deficiency assessment letter shows that prior to December 9, 1935 the trust income was assessed to the husband. (R. 14 and 15.)

Whatsoever the reasoning of the said majority opinion may be the actual basis of the opinion is and can only be the argument that death of a husband does of necessity terminate the obligation of a husband to support his wife. Death does do that as to what might be called the involuntary obligation that rests on the duty created by law when the husband marries and which may continue to be enforcible by a divorce Court while the husband lives.

But the agreement here involved presents a different duty; a duty imposed by contract. It was a pre-divorce agreement intended to apply even if the marital relation was dissolved and the single status of the parties restored. The right to the legal type of alimony which is supposed to be continuously adapted by the Court to the capacity of a living husband to pay and to the

needs of the wife was destroyed, but it was superseded by a self-imposed duty. *The duty was founded on a legal consideration.* When such a contract is made, it is regarded as a permissible contractual assumption by the husband of a duty to support. It is elementary that the payments which such a contract provides for a wife's support need not be as a Court would prescribe in an alimony case. The surrendered right "to bed and board" within the home is alone sufficient for what the husband agrees to pay for support. It is elementary that these support obligations, although based on mere agreement, have enjoyed a preferred status both under the income tax law and the bankruptcy act. They can not be discharged in bankruptcy. They are not taxed to the wife. They represent personal expense not deductible from the husband's income. Amounts unpaid under the contract would no more be credits against income of an estate than would the unpaid part of strict alimony payments that remain a claim against an estate. (10 Corpus Juris, 1075, 1076). *It is certainly elementary in bankruptcy law that if the payments agreed to be made for support happen to fall due after the death of the wife or after the death of the husband they are still support payments. At no time will discharge in bankruptcy affect them. That is determined in New York where the contract here involved was made.* (See pages 47-48 of the Brief attached.) The husband can not be imprisoned for breach of the new duty. It is a personal obligation but it is in no sense a personal service obligation. It can not be enforced except against property. But it can be so enforced against property either before

or after the husband dies. As to the effective after death remedies in such a case, see pages 55-58 of the Brief.

In any event the majority opinion is basically erroneous. It concedes that in any event the liability persisted. In fact a judgment for income deficiency was obtained on this contract after the husband died. The sole conceivable reason for discussing the character of payments intended for support which, in view of the events that transpire, happen to fall due beyond the joint lives of the spouses is the argument that the quality of the payments is lost if either spouse dies so that the balance of the payments suddenly represent a purchased annuity. However the case of *Helvering v. Butterworth,* 290 U.S. 365, 78 L. ed 365 seems to indicate that a person is not to be deemed a purchaser of an annuity unless the price is ascertainable by some standard.

The Government does not aim to tax any part of an annuity that is not profit. The provision for taxing annually so much of the annuity payment as equals 3% of the aggregate premiums or consideration is merely a means of insuring the taxing of possible profit. While the law formerly prevented taxing any part of annuity payments until the cost was returned, the taxing of the small percentage referred to is now permitted. (Sec. 22 (b)(2) Rev. Act, 1936; 49 Stat. at L. 1667.) There is no profit at all in annuity payments which but equal the price. Here Mrs. Clark lived less than two years after the husband died. He died December 9, 1935 and she died September 19,

1937 and we are concerned with the year 1936 and a part of the year 1937 and the possibility of argument that there was a purchase of an annuity payable to Mrs. Clark in the year 1936 and in the fraction of the year 1937. If we assume that the tables used by insurance companies gave to Mrs. Clark a life expectancy beyond the life of the husband of about two years, the charge for the annuity would probably have been about what Mrs. Clark received in the way of payments plus something for overhead. The legal situation thus created would mean that instead of trying to tax the whole of the payments made to Mrs. Clark the Government would be confined to taxing approximately 3% thereof and indeed that might be excessive. It would be entirely unfair for the Government to try to shift its theory simply to enforce payment of an utterly unfair tax. It taxed this income as income of an ordinary trust. (R. 17.)

It would seem the height of unreason and unfairness to say that the indulgence of the wife in deferring payment of certain sums for her support, or her doing that because the husband is in need of his funds and she is possibly temporarily otherwise provided for, his death or her death penalizes her and makes her pay taxes on income of a trust designed to secure the payments. The husband says to the wife: "Grant me ten days time to make one of the fixed payments for support." They so agree in writing, and thus make a legal change in their contract. The wife dies before the time is up. The opinion below means the payment has become gross income of the wife's estate. In the at-

tached brief we shall show that in New York it has been explicitly ruled that where in the separation agreement the parties—as here—recited the stipulated payments would be for support, it is immaterial that they happen to fall due after the joint lives of the parties and we shall additionally show that sanction for these rulings is found in a declaration in one Supreme Court case and in a ruling in another. The cases show that payments so agreed upon can not be discharged in bankruptcy because they are justly support payments. The attached brief will also bear on the elementary rule that death does not destroy a contract that is not for personal service or convert into ownership that which is security. It will answer, to any extent not herein answered, the point made in the majority opinion below that if in the agreement the wife waived her dower right or received a power of appointment makes a different case. But we may mention at once that the majority opinion failed to note that dower was waived in *Douglas v. Willcuts* and that a power to appoint was granted to the wife in the *Fuller* case. It failed to note that a power of appointment is not property and has no market value whatever. May we state respectfully that for 23 years the objections last mentioned remained undiscovered by the husband or by the Government. It failed to note that if the power was property, the grant of it probably reduced the support payments.

In *Douglas v. Willcuts*, 296 U. S. 1, 80 L. ed. 3, the Supreme Court refused to render the contract or the decree ineffective by saying that the regular payments

called for settled property rights. The decree was that the payments were "in lieu of all other alimony *or* property or estate of the defendant." Said the Court:

> "However designated, it was a provision for annual payments to serve the purpose of alimony, that is to assure to the wife suitable support. The fact that the provision was to be in lieu of any other interest in the husband's property did not affect the essential quality of these payments."

Under New York law neither husband nor wife had in 1906 an inheritance right in property of the other. The wife here waived her contingent right of dower. The husband waived his right of curtesy. So the wife stripped herself. These contracts would be of little worth as against bankruptcy, if the Court is to hold they may not settle property rights *and* provide for support. (Civil Code Cal. Sec. 159 is in the conjunctive.) If the right of support is lost because there is some sort of surrender, why not defeat the contract by argument that the home, the shelter and the conveniences surrendered by the wife were worth but half what the husband is to pay. The right way is to say, as the Government for 23 years must have said, that waiver of dower balanced waiver of curtesy. In any event, the law lets the parties agree what is fair for support in the up-set life that follows separation and they should not be permitted to deny their contract. Support, possible illness—all kinds of contingencies must be considered and judged. In the *Rider* case mentioned in the attached brief, the Court held the separation contract was a support contract *in the ab-*

sence of any showing as to the extent that settlement of a breach of promise claim influenced the payments. So, if there is anything in the point, the burden *is* on the husband to make out the claim.

In the *Tilles* case dower was waived. It is fair to state that such waiver is probably common to these contracts.

If there was any doubt about considering these contracts as containing a separate adequately supported provision for support, where no question of good faith can be raised under the evidence, *Douglas v. Willcuts* settles that. In the New York case cited at page 48, and in which it was held the payments that might be made after the wife died would be support and were not dischargeable in bankruptcy, the husband had received property from the wife and such was the *Tilles* case.

If the Court starts the journey from the explicit agreement, it could not only speculate as to what the right of the wife 30 years later, if she survived, to use a piece of real property would be, but it could also speculate as to what additional real property the husband might have acquired. The law is not so impractical. It would certainly seem utterly unfair to simply subtract an attempted valuation of dower from the total of what the wife receives. That legally gets nowhere. If valuing is to be done and the claim is that some part of a payment intended strictly for support is not support, the Court has the impossible task of determining, as of the date of the agreement, what in

dollars and cents the value of "bed and board" would have been which the wife had the right to by virtue of the marital relation. There are now 50 departments of the Superior Court in Los Angeles. Each judge has divorce jurisdiction. Were these judges to act independently on a divorce case of the same facts, the result would probably be a mass of different decisions as to what the proper amount of alimony should be. One judge might say that he believed the wife was in ill-health and had no earning capacity and another might attach little weight to the evidence on this point. One might have said, in the very type of case here presented, that, in view of the wealth of the husband and his earning capacity or income and the station in life of the parties, the sum of $30,000.00 annually would be proper support for the wife. Whether if dower was waived, the awarded payments would not have been more or less is mere surmise.

The point is that the law permits settlement of property rights in the agreement and also the making of provision for the wife's support.

What is dower measured as of February 28, 1906? Apparently in condemnation cases, it would present this kind of estimating. Consider such a sum as would if put at interest on February 28, 1906, produce the rental value of a third (or the legal fraction) of Mr. Clark's real estate from December 9, 1935 to September 19, 1937. But the wife would not immediately get this because the right is contingent. It would be impounded and if she died first or the law abolished dower, it would be the husband's property. The valua-

tion expert might have to consider deterioration or at least obsolescence. If the tables show the husband will outlive the wife, it would seem the valuation would be zero. But this does not end it. The husband waives curtesy which involves off-set. It would seem that it would here have involved subtracting one flea-bite from another flea-bite. Or looking at the thing from the other end this would be the situation. The wife has received $25,000.00 annually for about thirty years. Assume there was some real property that existed on February 28, 1906. Compare the money with use of the real property for about two years, noting that—to balance—the payments would be considered as drawing interest for an average of fifteen years. At 4%, that would mean interest totalling 60% of $750,000.00 which would have to be added to the $750,000.00, the total of the payments, to balance.

The law accords the privilege of agreeing on support and it does not presuppose that the Commissioner of Internal Revenue or a bankruptcy court shall go back thirty years and try to determine what a divorce court would in the subsequent period have allowed to the wife for support.

We shall first state the facts very generally and then explain the rulings in the alimony trust cases which bear on those facts so as to bring out the points involved. We shall then quote from the contract and from a judgment obtained on that contract, showing the payments were for support.

OUTLINE OF FACTS.

On February 28, 1906, James F. A. Clark and Estelle P. Clark were husband and wife residing in New York. They there made a separation agreement bearing said date which was intended to provide the wife $25,000.00 annually for her support. The parties had an adopted daughter who was a minor eight years old. The wife agreed to care for and support the child during its minority or until its marriage, if it married before becoming of age. The contract failed to provide for any payments directly for the child's benefit. It ended at the death of the wife. In the agreement the husband transferred a large amount of securities to Colonial Trust Company of New York as trustee and authorized the trustee to collect the income from the securities and to pay it—to the extent of $25,000.00 annually—to the wife for her support during her life. (If the wife obtained a divorce and remarried, the payments were reduced to $15,000.00 annually. She obtained a divorce. She did not remarry.) The husband guaranteed the income would be $25,000.00 annually. Excess income was payable to the husband. If securities defaulted as to income, the husband was required to substitute paying securities. The husband expressly agreed the contract would be binding on his estate. A final judgment (hereafter mentioned) was obtained by the trustee after the death of James F. A. Clark determining that the contract was binding on his estate. This judgment required the estate to make up a deficiency in income of $4040.06 for the year ending July 7, 1936.

Investments in the trust could be changed only with the husband's consent. Subject only to the wife's

testamentary power to appoint a part of the property in the trust, the reversionary interest in the trust was retained by the trustor.

The wife waived dower. (Par. Eleventh, R. 53.) The husband waived curtesy. (Par. Twelfth, R. 54.)

The District Court of Lincoln County, South Dakota, granted the wife an absolute divorce on October 1, 1906, the decree reciting "Ordered, * * * that no allowance be made to plaintiff for alimony, support or maintenance" and that it should not be subject to future modification. (R. 60, top of page.) It is conceded this decree was final in this respect.

The Contract Was Valid for the Life of the Wife.

Time and again it has been ruled in New York that *the parties may distribute the payments agreed to be made by the husband to the wife for her support so that part will be payable after death,* that with the consent of the husband an alimony decree may so provide.

> *Babcock v. Babcock,* 147 Misc. 900, 265 N.Y.S. 470;
>
> *In re Tashenberg's Estate,* 149 Misc. 124, 267 N.Y.S. 502.

This is the law generally and the Federal Courts would be forced to recognize the state rule on this point if the law were not general.

> *Whitney v. Whitney Elevator & Warehouse Co.,* 180 Fed. 187, 106 C.C.A. 28 (cert. den. 219 U.S. 588, 55 L. ed 348).

Rulings Already Made on Contracts that Ran Beyond Period During Which Alimony Might be Awarded.

We earnestly contend that by its denial of certiorari in the *Alsop* case and by its denial of the writ in *Barbour v. Commissioner* (which involved the same point as did the *Glendinning* case and the *Weir* case) this Court meant to make income from such a security trust as that which is here involved income of the husband, and that it is immaterial that times of payment called for by his agreement are in a period when, had jurisdiction of a divorce court been originally exercised or retained, payment would not have been or could not have been required.

In the *Alsop* case the husband's agreement was to make the support payments *for the life of the wife.* She remarried and the argument was that as alimony could not be made payable after the wife remarried, the trust income was the wife's. But the Court ruled that the *agreement* bound the husband, and the Court in this case has erroneously said the case is not in point. But the Court there said:

> "Whatever this agreement may be called, 'a family settlement' or anything else, it was in lieu of alimony *for her entire life.*"
>
> *Alsop v. Commissioner of Internal Revenue,* 92 Fed. (2d) 149, 150 (certiorari denied Jan. 31, 1938, 302 U.S. 767, 82 L. ed. 595).

The following case clearly approves precisely the ruling of the *Alsop* case and cites as in harmony this Court's ruling in *Helvering v. Coxey,* 297 U.S. 694, 80

L. ed. 986, which was made on the authority of *Douglas v. Willcuts* and the cases which followed.

Donelley v. Commissioner, 101 F. (2d) 879, 882.

In *Glendinning v. Commissioner,* 97 Fed. (2d) 51, it appeared that under the laws of Pennsylvania the husband could not by Court decree be obligated to pay anything to his wife, after divorce, as support and maintenance. However, prior to the decree which the husband obtained, the husband created a trust, in which he became obligated to pay the wife an annual *sum for life* for her support. He, under the contract, remained personally liable. It was in effect ruled that the trust was created as a substitute for a Court order for support *that could have been made effective prior to the divorce.* The husband was held liable for tax upon the payments resulting from the trust, the Court stating in part at page 52, "but the income from a trust fund put up to meet an obligation of the creator of the trust, is the income of the debtor."

The ruling in the latter case was followed on the second question decided (which we have explained) in

Weir v. Commissioner, 109 Fed. (2d) 996.

In *Barbour v. Commissioner,* 110 F. (2d) 660, it was stated *that the question involved was identical with the second question decided in the Weir case,* and in *Barbour v. Commissioner,* certiorari was denied. (310 U.S. 682, 84 L. ed. 1399, 60 S. Ct. 976.)

In the following case the husband agreed in a pre-divorce separation agreement to make payments to the wife for her support *for life.* The husband obtained

the divorce. It was admitted that the Missouri divorce Court could not have awarded alimony to the wife if the husband obtained the divorce. To secure the payments a pledge of securities was created. *The wife had transferred securities to the husband. She waived her dower rights.* The question was as to whether income of the pledge accruing in 1931 was the husband's income. It was held that when the separation agreement was made—which was before the divorce—he could contract to support his wife for life. It was held that the income from the pledge was taxable to the husband. Seemingly to make an end of the controversy, the Court, after a review of the alimony trust cases, said explicitly that the contract would have the same effect if the husband should die or if the wife remarried.

> *Tilles v. Commissioner of Int. Rev.*, 113 F. (2d) 907.

And certiorari was denied in this case:

> 311 U. S. 703, 85 L. ed. 456, 61 S. Ct. 59.

The following is a summary of the alimony trust or separation cases in which the husband distributed his obligation over a period beyond his life. That is, he measured his obligation by the life of the wife, or by a period that might extend beyond the husband's life. Kindly note that we have:

(Cases determined here.)

1. In *Douglas v. Willcuts*, a contract for life.

2. In *Helvering v. Leonard*, a contract for life.

3. In the *Fuller* case, a contract for a definite term which might exceed the husband's life.

4. In ***Pearce v. Commissioner,*** a contract for life.

(Lower Court cases.)

(a) In the ***Alsop*** case, a contract for life.

(b) In the ***Weir*** case, a contract for life.

(c) In the ***Glendinning*** case, a contract for life.

(d) In the ***Tilles*** case, a contract for life.

Further as to Foundation of Ruling Below.

The only justification for the lower Court's ruling is the decision in the *Thomas* case (100 Fed. (2d) 408). In that case the husband had died. While that case might possibly be said to involve features of an alimony trust case, the facts were so complicated that the Board of Tax Appeals did not cite it. (R. 22 to 26.) There was a compromise after the husband and wife made their original contract. It could be argued that the payments to be made to the wife lost their identity as support payments. Certainly this case was the first case to treat it as a precedent which should be followed here. There was first an opinion by Judge Augustus Hand. That opinion suggests possibly that the parties must have agreed that waiver by the wife of her dower right had constituted the consideration for the alimony payments made after death, because—it was argued—the right of the wife to claim support from the husband ceases at death. It must be conceded that any such allocation of consideration as that would be fiction; that there was nothing in the contract that justified that.

In the *Thomas* case Judge L. Hand wrote an opinion in which he justified taxing the wife on the income after death of the husband as a matter of convenience. His opinion said:

> "If it were practicable to continue the tax upon his estate after his death, I should therefore think that was the proper way * * * he has given a quid pro quo measured by a less sum for a longer period."

Judge L. Hand had to say that in view of his opinion in the *Adams* case, a bankruptcy case, cited in the appended brief.

Possibly Judge L. Hand had the view that is suggested in the majority opinion here, that the law aimed to tax the income of an alimony trust as to a separate person. There is no such intent. Whether there will be a tax as well as the amount of the tax will depend on the remaining income and the credits and deductions of the husband. Income that is distributable annually is merely the income of the recipients thereof. The trust is taxed as a separate entity only as to capital gains and income accumulations.

To the argument of convenience made by Judge L. Hand there are two answers:

First: In view of the fact that the law and the regulations explicitly sanction creating a trust the income of which secures the promise to pay of any debtor, the argument leads to absurdity. It obviously is not the law that if the creditor is a bank or lending institution, death of the debtor will shift the tax and

require counting the trust income as a part of the income of the creditor.

SECONDLY: The inconvenience is no different from that which results from death of debtors in other cases. Never is the effect of the passing of the debtor's estate the same in two cases. Increase or decrease in taxable income may result. That the inconvenience produced by the type of case has some special features is no reason for telling a bank or an ex-wife that death has converted that which was security into absolute ownership.

(The first answer is sufficient and we trust that the argument with respect to the second will not be treated as an apology for the first. There is no apology for the first, even if the conclusion should mean loss in taxes.)

Note what happens when the rich parent dies. He pays a heavy income tax. So does his estate. The law declares his estate is a person; likewise a trust; likewise a partnership. (Internal Revenue Code, Sec. 3797.) But the trust is not taxed as a person except to a limited extent; the partnership not at all. The estate is taxed as a person during administration. The decedent may leave a dozen children; he may will his property to forty people. The identical amount of income from the identical property may pay no tax at all.

The sole disturbance is: What happens to the fine set-up if the rich ex-husband who has created an alimony trust which secures his continuing obligation happens to die? It may be argued that income com-

mitted to the payment of the debtor's debt, whether it be from a trust in personalty or from a mortgage of crops on real property or from a pledge of personal property remains income of the debtor if he lives, even if he, by a sale or gift, parts with the entire equity in the property the use of which is so committed—this upon some theory that creating the debt and the security was some sort of an irrevocable commitment of the income, something that made it unalterably a particular item of gross income of a particular debtor, even though title to what produced the income passed; that forever or until the debt is paid that income must always show up in the gross income of the original debtor.

Having in mind that the fact that any trust is, in so far as the rights of the trustor are concerned, just as alienable as are the rights of a mortgagor or a pledgor, the theory last mentioned would seem to be entirely unsound or that the law has inadvertently created a freakish result in a case because the security is trust income. Obviously a mortgage of crops extending for several years or a pledge of income of securities would cover income only.

If in his lifetime the trustor by a transfer in good faith divested himself of the residuary interest in a trust set up as security or if he was divested by execution or bankruptcy of that interest, it would seem clear that the person who acquired the encumbered property would count the entire income therefrom in his gross income. *He could not claim as a deduction or as current expense, the amounts which the income an-*

nually retired in relieving the property of the encumbrance because that would be improvement of his position and in the nature of a capital disbursement. That would be considered equivalent to buying the title; equivalent to succession to a title being acquired under contract to purchase.

Suppose the debtor dies and the encumbered property passes by will or inheritance. Death creates complication for the creditor as well as the government. Where the claim is contingent the creditor can (as is frequently done) ask to have impounded enough of the estate to make reasonably certain the contingent claim will be paid. The equity in the deposit and the balance of the estate goes to the heirs or as the will provides.

But says the Government: Who would want the trustor-interest in a trust in a large amount of assets when annually the income from those assets might be largely taken to pay a debt of the decedent. Of course, it is the law that what a will gives may or may not be accepted. But that alters not the slightest the rights of the creditor, Estelle P. Clark. It is just one of those situations which death and not her act has created. We have diligently sought an express answer in the income tax law and the cases to the question: Must the devisee who takes land heavily mortgaged or the income of which is hypothecated for years (which is practically the same thing) report the yield therefrom as a part of his gross income? We find no exact precedent, but we believe the answer

is "Yes" and that there is no real hardship. The income is virtually buying the place by paying the charge down to zero and the payments out of income would not be a deductible by the devisee.

Section 22 of the Internal Revenue Code says that gifts under a will are not income but that yield therefrom is income and would be rational to say such yield is income of the beneficiary although it goes to a creditor, if the payments purge the title.

The value of the assets in this trust plus cash were over $400,000 at Mrs. Clark's death. So at least in this case there would not, in view of the wife's probable age, be hesitancy to accept the trust estate.

Why create a tax against the ex-wife or a lending institution, simply because the promisor has died?

This contract was made in good faith before we had an income tax law. *If Congress desires to have alimony trusts taxed as a unit or if Congress desires to have security trusts taxed as a unit, it should be done by a new law, and not by Court decision. It does not tax to the trustee income which is distributable.*

> Note Regulations 94, Article 162-1 (3) and present Regulations 103, Sec. 19.162-1(3) hereinbefore quoted.

The present regulations declare:

> "Interest paid by the taxpayer on a mortgage upon real estate of which he is the legal or equitable owner even though the taxpayer is not directly liable upon the bond or note secured by such

mortgage may be deducted as interest on his indebtedness."

Regulations 103, Art. 19, 23-b-1.

Note the reference was to *interest* only.

This court has stated that the income tax law is to be construed as intending to tax what amounts to income within any of the defined categories. (*Helvering v. Clifford,* 309 U.S. 331, 84 L. ed. 788.) So it could be urged that the income from the legacy charged with an obligation would be included in the income of the legatee.

We now deal with the *Pearce* case which is cited in both opinions below. (Probably the *Leonard* case should be stressed because the opinion in that case meets the statement in the majority opinion that all Mr. Clark or his estate did was to guarantee against income deficiencies.)

We may first mention *Douglas v. Willcuts,* 296 U. S. 1, 80 L. ed. 3, as the *Pearce* case opens with a reference to that case. There the husband made an agreement immediately preceding the entry of the divorce decree by the Minnesota court, in which he undertook to pay to his wife fixed payments *for life*—the sum of $15,000.00 up to November 6, 1927 and thereafter $21,000.00 annually. *The wife waived her dower right.* It was agreed that the support payments would be secured through income of a trust. Excess income went to the husband in case principal was not impaired. Deficiencies were to be made up in a prescribed manner by the husband. The contract recited that it "was in

lieu of any and all claims for support, maintenance and allowance for her support". (Such is the contract here.)

The decree of divorce adjudged that the trust should be set up and that its provisions should be *in lieu of alimony and the wife's interest in the property or the estate of the defendant.* The Court ruled that it could not be said that the divorce court had not allowed alimony or that its jurisdiction was lost. It held that the trust income secured the continuing obligation of the husband to make payments to his wife, that it was used *to serve a purpose of the husband,* and was his income. It quoted from the *Butterworth* case, as follows:

> "The court observed that 'evident general purpose of the statute was to tax in some way the whole income of all trust estates'."

Now, of course, this statement last mentioned, which is mentioned in the majority opinion below, was not intended by the Supreme Court to be taken in a literal sense. The husband, might not have been taxed a penny on this trust income. It had to be counted as a part of his gross income and his deductions might have left no tax whatsoever.

In the *Pearce* case, the husband agreed in writing to pay his wife $500.00 a month *for the rest of her life.* The wife obtained an absolute divorce under Texas law in the year 1917. The decree was silent on the question of alimony. The contract reserved to the husband the right to substitute for his obligation an

annuity contract. Following the divorce, he provided the wife with the annuity. The Circuit Court of Appeals held that it was not enough for the wife to show that under the Texas law the divorce court *might* have power to change the decree; that to overcome the Commissioner's ruling it was essential that the wife should establish that the law was clear on this point. The Supreme Court granted a review because of the standard applied. It held *that the burden in these cases is in the main on the husband.* It said:

> "We do not think that that was a correct application of the Fitch or Leonard cases. Those cases hold that the income is taxable to the former husband, not only where it is clear that payments to his ex-wife were made pursuant to a continuing liability *created by his contract or by local law, but also where his undertaking or local law makes that question doubtful or uncertain.*"

But the Court held that even within this favorable rule the wife had not made out a case.

The Court then explained exactly what it had ruled in the *Fitch* case, the *Fuller* case and the *Leonard* case.

1. It said that the *Fitch* case determined that while the wife's right to income from the alimony trust purported to be limited to $600.00 a month and there was no guaranty of the income by the husband, yet he had not shown that the Iowa divorce court could not change the amounts payable by him. (*Helvering v. Fitch,* 309 U. S. 149, 84 L. ed. 665.)

2. It said it had made the same ruling in the *Leonard* case. There, as will be shown, the husband had, as here, guaranteed income from certain securities which income went to the wife for life. And on that ground *also* it was ruled the husband was held as to part of the payments. (*Helvering v. Leonard,* 310 U. S. 80, 84 L. ed. 1087.)

3. The Court then dealt with the *Fuller* case. (*Helvering v. Fuller,* 310 U. S. 69, 84 L. ed. 1082.) There certain support payments were to be made during *a definite term, which of course, might exceed the life of the wife.* Unguaranteed income of a trust was to be paid to the wife for a like period. The Court said:

> "In the Fuller case it was clear under Nevada law that the court retained no control over the divorce decree which approved the trust settlement. Since there was no such reserved power and since the trust contained no contractual undertaking by the husband for support of the wife, we concluded that his obligation to support had been pro tanto discharged. *We held, however, that the husband was taxable on a $40 weekly payment which he had agreed to make to his wife.* But that fact did not make him taxable on income from the trust also, since the provision for weekly payments and the trust 'were not so interrelated or interdependent as to make the trust a security for the weekly payments'. 310 U. S. p. 73, 84 L. ed. 1084, 60 S. Ct. 784. We also noted (p. 76) that though 'the divorce decree extinguishes the husband's pre-existing duty to support the wife, and though no provision of the trust agreement places such obligation on him that the agreement may

nevertheless leave him with sufficient interest in or control over the trust as to make him the owner of the corpus for the purpose of the Federal Income tax under Helvering v. Clifford, 309 U. S. 331, 84 L. ed. 788, 60 S. Ct. 554'.

Thus a property settlement made for the purpose of maintaining or supporting the wife may be treated for income tax purposes as mere *security* for the husband's continuing obligation dependent on such consideration as whether it contains, *or* is interrelated with, contractual obligations of the husband for her support; whether the court has a reserved power to alter or modify it; *or* whether the husband retains any substantial interest in the property conveyed. Where the settlement carries some of the earmarks of a security device, then the power of the court to add to the husband's personal obligations may be especially significant. See Helvering v. Leonard, 310 U. S. 80, 84 L. ed. 1087, 60 S. Ct. 780, supra. But where, as here, the settlement appears to be absolute and outright and on its face vests in the wife the indicia of complete ownership, it will be treated as that which it purports to be in absence of evidence that it was only a security device for the husband's continuing obligation to support."

Pearce v. Commissioner, 62 U. S. Ct. 754, 86 L. ed. Adv. Sheets 679.

The *Pearce* case is not a full summary of the part of the *Leonard* case which is the same as this case. There, as here, Leonard, the former husband, guaranteed that certain securities placed by him in an alimony trust would yield certain amounts *for the life* of his wife. And it is the part of the decision that

relates to this special provision which is so obviously in point here. There the agreement involved:

1. Putting $650,000.00 in a trust of which $400,000.00 were 6% bonds.

2. Guaranty of payment of the interest on those $400,000.00 in bonds for the wife's support *for life.*

3. If the total trust income fell below $65,000.00, the husband was to make up the deficiency but under specified contingencies, this could be limited to $55,000.00.

The Commissioner, Helvering, lost out below, the Board and the Court ruling; *first,* that it was not a security arrangement at all, and *second,* that the Court lost divorce jurisdiction to change the contract. The Commissioner appealed. Both grounds were overruled.

The Supreme Court first proceeded to single out the guaranty and explicitly ruled that the guaranty of payment of the 6% interest on the $400,000.00 in bonds was taxable to Leonard because to that extent at least the agreement created a debtor-creditor-security arrangement. Said the Court:

> "For *these reasons* that portion of the trust income which was received from the guaranteed bonds was clearly taxable to respondent."

The Court further said:

> "Hence the case in substance is the same as those where pursuant to contract or arrangement an obligation is discharged by another for the tax-

payer's benefit; see Old Colony Trust Co. v. Commissioner of Internal Revenue, 279 U. S. 716, 73 L. ed. 918, 49 S. Ct. 499; United States v. Boston & M. R. Co., 279 U. S. 732, 73 L. ed. 929, 49 S. Ct. 505; or where the taxpayer creates a trust, the income of which is applied to the discharge of his debt. See Helvering v. Blumenthal, 296 U. S. 552, 80 L. ed. 390, 56 S. Ct. 305. Here, as there, the taxpayer received a benefit by the payments."

Helvering v. Leonard, 310 U. S. 80, 84 L. ed. 1087.

(We wish to mention that Judge L. Hand participated in the erroneous ruling below and this is some indication of a mistaken notion on his part as to the nature of these cases.)

Leonard did not agree to make the payments of $24,000.00 annually. But as here, he guaranteed them. Here Mr. Clark agreed for himself and his estate to guarantee them. (Par. Third, R. 46.) Mr. Clark agreed to put good securities in the trust for bad. (Par. Sixth, R. 51.) Under Par. Tenth (R. 53) Mr. Clark was clearly the person responsible for investments. He was the one to change securities although this was to be with the approval of the trustee or Mrs. Clark. The trustee assumed no responsibility for investments. (Par. Fifteenth, R. 55.) By express terms the agreement was binding on the decedent's estate or legal representatives. (Par. Nineteenth, R. 57.)

We now make more specific references to the record and the agreement in order to establish each fact asserted.

When James F. A. Clark and Estelle P. Clark made their contract dated February 28, 1906, they resided in New York. (Item 1, R. 38.)

Extracts from agreement:

> "* * * and the party of the first part is willing to provide for the support of his wife and child, so as to avoid proceedings against him for compulsory support; and
>
> Whereas, the party of the second part is willing to accept a satisfactory allowance properly secured, provided it is without prejudice to her legal rights based on the conduct of the party of the first part;" (R. 45.)
>
> "Third: The party of the first part hereby agrees to assign and transfer unto the Trustee, and at all times to keep and maintain in the hands of the Trustee good, valid and marketable securities of a market value which shall at no time bear and yield an annual income of less than Twenty Five Thousand Dollars ($25,000)." (R. 46.)
>
> "Fourth: * * *
>
> (a) That the Trustee shall during the life of the party of the first part, receive and collect the interest, income and dividends upon the said securities, and upon any other or substituted securities that may be transferred and delivered to it as hereinafter provided, and shall pay over the same to the party of the second part quarterly, or semi-annually, as the same are collected, during the lifetime of the party of the second part. If in any year the said interest, dividends and income so paid shall exceed the amount of Twenty Five Thousand Dollars ($25,000) the surplus shall be

paid to the party of the first part or his legal representatives. Provided, however, that if the party of the second part shall meantime have procured an absolute divorce from the party of the first part and shall have remarried, from and after such remarriage there shall be paid to her out of the interest, dividends and income from such securities or from any substituted securities, the sum of Fifteen Thousand Dollars ($15,000) per annum, and no more, and in such event the entire surplus of income over and above said annual sum of $15,000 shall be paid to the party of the first part or his legal representatives." (R. 48, 49.)

"(d) Upon the death of the party of the second part, the trusts hereby created except as to the aforesaid sum of $150,000 above provided for, to be disposed of by the party of the second part by will, shall cease and determine, and all the remaining securities then in the hands of the Trustee, under the trusts hereof shall be transferred and paid over unto the party of the first part or his legal representatives, or as he shall direct by will or otherwise." (R. 49, 50, 51.)

"Sixth: If at any time during the existence of the trusts hereby created, there shall be a default in the payment of interest or dividends upon any of the securities then constituting a part of the trust estate hereby created, the party of the first part will forthwith, upon the demand of the Trustee, assign, transfer and deliver to the Trustee, in substitution for those securities defaulted, securities of a character approved by the Trustee, or by the party of the second part, which shall yield an income equal to that of the securi-

ties on which the default of interest shall have occurred, or with respect to which the dividends shall not have been paid. The failure or omission of any corporation the securities of which are to be held by the Trustee to pay its usual dividend at the time at which the same is ordinarily paid, shall constitute a default within the meaning hereof.

Seventh: If the securities forming part of the trust estate, shall in any one year yield unto the party of the second part an income of less than $25,000, provided the party of the second part shall not meantime have married, or less than $15,000, provided she shall have remarried, the party of the first part shall forthwith make good such deficiency by paying the amount thereof to the Trustee." (R. 51, 52.)

"* * * the intent hereof being to provide for the party of the second part *such support* as she would be able to enforce, but for the provisions hereby made. No judgment or decree of divorce hereafter procured by the party of the second part, shall in any way invalidate or affect the trusts of this agreement." (R. 55.)

"* * * provided, however, that the net annual income, payable from said estate to the party of the second part, shall be at no time less than the amounts above fixed, and the party of the first part shall make good any deficiency in the said income, including therein the expenses of the administration of this trust." (R. 56.)

"Nineteenth: This agreement shall bind the respective heirs, executors and legal representatives of the parties of the first and second parts." (R. 57.)

On October 1, 1906, in South Dakota, the wife obtained an absolute divorce. The divorce decree is Exhibit 2 of the stipulation. It specifically denied alimony. In that respect it was final. (*Cameron v. Cameron,* 31 S. D. 335, 140 N. W. 700.) (Item 3, R. 39 and 57.)

The ex-wife never remarried. (Item 4, R. 39.)

James F. A. Clark died December 9, 1939 and Central Hanover Bank and Trust Company became his executor. (Item 7, R. 39.)

Estelle P. Clark died September 19, 1937 a resident of Alameda County. Her will attempted to exercise the power of appointment reserved in subparagraph (b) of Par. Fourth of the agreement but the validity of the exercise of the power is under attack. (Item 8, R. 39 and 40.)

The petitioners herein are the executors of the will of Estelle P. Clark. (Item 9, R. 40.)

In his lifetime, James F. A. Clark substituted good securities for defaulting held under the agreement of February 28, 1906, and he directed changes in the trust securities. (Item 11, R. 41.)

On June 23, 1937, the trustee under the trust agreement obtained a judgment against the estate of James F. A. Clark for $4040.06, as income deficiency under the trust for the year ending July 7, 1936. The suit in which the judgment was rendered was brought also for the purpose of obtaining construction of the agreement and to have the trustee's account settled. Defendant appealed from the said judgment, but

"Following the death of decedent which occurred on September 19, 1937, said appellant withdrew its appeal and said judgment is now final." (Item 12, R. 42, mid-page.)

This judgment provided:

"Ordered, Adjudged and Decreed that it was the intention of the said James F. A. Clark and Estelle P. Clark, that the covenants and provisions contained in the said agreement should be binding upon their respective executors and administrators; and it is further

"Ordered, Adjudged and Decreed that the rights and obligations of the respective parties to the agreement of February 28, 1906, were intended by the parties to be in lieu of and in substitution for any and all obligations resting upon said James F. A. Clark for the maintenance or support of Estelle P. Clark;" (R. 102.)

At the death of Mrs. Clark on September 19, 1937, the securities in the trust exceeded in value $400,-000.00. In some years the trust income exceeded $25,-000.00. This excess was paid to Mr. Clark. (Item 13, R. 42 and 43.)

The divorce decree shows that the divorce was absolute and that no alimony was allowed. (Item 14, R. 58 to 60.)

The Court will observe that in the agreement of February 28, 1906, there was no disposition of the reversionary interest in this trust. There could be no change in the securities held by the trustee except as directed by James F. A. Clark although it was re-

quired that either the trustee or Mrs. Clark should consent. This right was reserved on behalf of James F. A. Clark and his estate. (See Par. Tenth, R. 53.)

Moreover, the agreement expressly stated in Par. Fifteenth that the trustee should be in no respect responsible for investments. (R. 55.)

It was stipulated:

> "He made good deficiencies when the income of the trust was less than $25,000 for any fiscal year ended July 7, as provided in the Seventh paragraph of said agreement and from time to time he made changes in the securities included in the trust with the consent of the trustee or the decedent, as provided in the Tenth paragraph of the agreement." (R. 41.)

IMPORTANT QUESTIONS INVOLVED.

The Court should grant a review in this case in order to have correctly answered the following questions.

1. Whether the majority opinion below has not misapplied the *Pearce* case and created an illegal guide.

2. Whether the parties to this contract could give to the payments which were to be made to the wife after the husband's death the same character which they gave to the payments made before such death.

3. Whether the cases decided by this Court indicating these contracts are support contracts, although they may run beyond the husband's life, are in error.

4. Whether the *Alsop* case, the *Donnelly* case, the *Glendinning* case, *Weir* case, the *Barbour* case and the *Tilles* case, all indicating that by contract the parties can distribute the support payments over a period in which the making of support payments could not be compelled, are erroneous.

5. Whether the two New York cases on this point mentioned in the attached brief are in error.

6. Whether, if under local law where the contract was made the after-death payments are ruled to be for support, the Federal Courts should not so treat them.

7. Whether the death of the husband does in such a case as this convert that which was income of the husband into income of the wife.

8. Whether, if the contract to make the payments means it shall be binding upon the husband's estate if he dies first, there is any legal factor or any change in remedy that so alters the creditor-debtor-security arrangement as to require a holding that after the husband dies the income of the trust must be treated as income of the wife.

Whether, if there was a lien on trust corpus to secure income deficiencies we would not have a plain case of security.

9. Whether the Court below did not misapply the *Leonard* case and the law generally in holding that if all that the husband or his estate is liable for is to make up income deficiencies, the case is taken out of the case which hold that the income is taxable to the husband.

10. Whether, the Court below did not misconstrue the *Butterworth* case in saying, in effect, that the law intends the trust income shall be taxed as a unit.

11. Whether, the Court below did not misconstrue and misapply the Treasury Regulations governing the taxing of income on alimony trusts.

12. Whether the retention of the interest by the husband in the trust and his control over it did not at least create a doubt as to whether the trust was a trust to serve the husband's purposes.

THIS COURT HAS JURISDICTION.

Judicial Code, Section 240(a);
28 *U. S. C. A.,* Section 347(a);
Magnum Import Co. v. Coty, 262 U. S. 159, 43 S. Ct. 531, 67 L. ed. 922.

The brief will follow.

Wherefore, petitioners respectfully pray the writ of certiorari issue out of and under the seal of this honorable Court, directed to the Honorable Circuit Court of Appeals for the Ninth Circuit in San Francisco, requiring that Court to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered 9879 on its docket and entitled "Stuart Daggett, Sr., and American Trust Company, Executors of the Last Will and Testament of Estelle P. Clark, Deceased, Peti-

tioners, vs. Commissioner of Internal Revenue, Respondent" and that the said decree of said Court may be reversed by this Honorable Court and that your petitioners may have such other relief in the premises as to this Honorable Court may seem meet and just.

Dated, Berkeley, California,
September 4, 1942.

NORTHCUTT ELY,
Attorney for Petitioners.

REECE CLARK,
GEORGE CLARK,
Of Counsel.